

SECRET

14 July 1981

MEMORANDUM FOR THE RECORD

Staff Meeting Minutes of 14 July 1981

The Director chaired the meeting. []

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The Director discussed today's Washington Post articles (attached) containing allegations that some years prior to coming to CIA Max Hugel engaged in improper or illegal stock market practices. He noted that Hugel has denied these allegations but because they have become such a burden to the Agency and Administration had tendered his resignation effective close of business today. Mr. Casey stated that he had accepted it with deep regret and had appointed John Stein new DDO. []

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The Director noted that he was scheduled to testify this morning before the SSCI on Covert Action Perspective No. 10. []

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The Director commented that he was not pleased with the story that appeared in today's New York Times (attached) on illegal arms exports and allegations of CIA involvement in these activities. []

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The Director discussed the overseas pay incentive program and said that he would sign letters to Congressmen Boland and Addabbo explaining his position. []

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The Director and Stein left to testify before the SSCI. Admiral Inman conducted the meeting at this point. []

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Fitzwater reported on a continuing FOIA request on the CIA "deergun." Fitzwater showed a schematic of the weapon. []

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Gates entered the meeting at this point. []

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[]

McMahon reported that NFAC has agreed to provide NASA analysis of certain missile and space related telemetry. []

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[] reported that he was convening a meeting with representatives of CIA, DIA, and INR to discuss how to speed up the estimative process. []

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[] noted that there will shortly be papers on Indian Ocean Islands and Ballistic Missile Defense. []

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Admiral Inman commented that the Director would like to have an IIM or a SNIE on the potential for guerrilla activity in Central America. Admiral Inman stressed that the paper should not contain analysis of the effect U.S. involvement would have on any guerrilla activity; that could be the subject of a separate paper. []

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[] reported that recruiting of new NIOs is being actively undertaken. []

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Attachments

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ON PAGE A1

THE WASHINGTON POST
14 July 1981

CIA Spymaster Is Accused of Improper Stock Practices

Hugel Denies Leaking Inside Business Information

By Bob Woodward and Patrick E. Tyler
Washington Post Staff Writers

Max Hugel, who holds one of the most sensitive jobs in the Reagan administration as chief of the CIA's clandestine service, engaged in a pattern of improper or illegal stock market practices in the mid-1970s that was intended to boost the stock of the New York wholesale firm he headed, according to two former business associates who secretly tape-recorded Hugel's business conversations.

The allegations against Hugel, 56, are made by two former Wall Street brokers, Thomas R. McNell, 49, and his brother Samuel F. McNell, 47, who charge that they participated with Hugel in a series of prohibited practices which deceived other investors. Several securities experts, consulted about the case, agree that Hugel's participation in these activities, if true, would be at least improper and perhaps illegal.

The McNells' tapes and documents corroborate these accusations: Hugel provided them with "insider" information on the company he headed in advance of disclosure to other investors and the general public; Hugel improperly funneled funds to McNell Securities, the principal firm trading in his company's stock, Brother International Corp., through loans to Samuel McNell as a middleman.

The McNells, who admit their own culpability in these activities, further allege that Hugel, relying on a business associate, orchestrated the phased purchase of 15,000 shares of his company's stock to create the appearance of increased market interest in it.

As the Central Intelligence Agency's deputy director for operations, Hugel today has access to the U.S. government's most

important secrets and directs the agency's worldwide network of covert intelligence agents. He emphatically denies any wrongdoing in his business relationships with the McNells and accuses them of threatening him with "blackmail" when he tried belatedly to sever the business connections and collect several hundred thousand dollars in loans.

Hugel, however, did not report any blackmail threats to the CIA's Office of Security which reviewed his past for the necessary security clearances. Hugel describes the McNells as "vindictive" people who, among other things, tried to swindle him. He dismissed all of their accusations as resentments left over from their ill-fated business connections in 1974 that ended in bankruptcy for Thomas McNell.

Beyond the accusations of improper behavior, the McNell tapes portray Max

Hugel as a combative and volatile person, given to profanities and angry expressions. At one point, when the business relationship was souring, Hugel expressed his rage at the McNells' Wall Street lawyer. "I'll kill the bastard," he said. On another tape, Hugel suggests that Thomas McNell might be found "hanging by the balls" if the outstanding loans were not repaid.

These revelations of stock market irregularities confront the leadership at the CIA with special irony. Hugel was brought from the Reagan campaign organization into the sensitive job of spymaster by CIA Director William J. Casey over the objections of some senior officials to his lack of experience. Casey is himself a former chairman of the Securities and Exchange Commission which polices Wall Street and he chose as CIA general counsel Stanley Sporkin who for many years was the chief enforcement officer at SEC and well-known for his tough approach to shady practices in the stock market.

In an unusual four-hour session last Friday, Hugel, accompanied by his two lawyers, and Sporkin, representing the CIA, met with reporters and editors at The Washington Post to review the accusations and records. Hugel said he canceled a weekend trip on an important overseas "operation" in order to confront the charges.

"There isn't any question I won't answer," Hugel said. "This is a very serious matter, my friends. My personal reputation is at stake. I intend to see this thing through to its very end."

Hugel and his attorneys requested a second meeting with Post reporters yesterday at which they presented some documents and repeated Hugel's denials. Hugel said some of his emphatic denials of last Friday may have appeared misleading, particularly in light of the tape recordings, but he had no intention of deceiving. Again he said he is innocent of any intent to conspire with the McNells or anyone else.

"I never profited one penny from the purchase or sale of Brother stock," Hugel said. Of his 20 years with Brother International, he said, "I'm proud of what I did and I'm proud of it now."

In Friday's response to point-by-point questions, Hugel denied ever sharing any "insider" information with the McNell firm while it was making a market in his company's stock as well as the other allegations. When several of the tape recordings were played for him and his lawyers, Hugel said he recognized his own voice but he didn't know what to make of the conversations. His lawyers advised him not to answer further questions until they could search his own records dealing with the seven-year-old transactions.

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Thomas McNell acknowledges that he and his brother remain deeply bitter toward Hugel, who received the final loan repayments only last fall. McNell characterizes their mutual transactions in the strongest terms.

The brothers allege that in early 1974 their firm, McNell Securities Corp., agreed to become a "market maker" for over-the-counter stock in Brother International Corp. of which Hugel was president. Normally, a broker who agrees to trade in a stock, buying and selling to other investors, is supposed to keep an arm's length relationship with the company involved so it will give unbiased advice to investors. But, from the start, Hugel and the firm established closer ties, including inside tips and improper loans, according to the McNells, special ties never disclosed to investors.

The scheme provided potential business advantages to Hugel who owned 200,000 shares in his company, or 11 percent of the outstanding stock. But, according to the McNells, the arrangement did not succeed in providing the ultimate profits they originally envisioned because the economic recession of late 1974 put stock prices in a slump, including the shares of Brother International. Overextended on market credit, the McNell firm was forced to close and the McNells entered acrimonious negotiations with Hugel over repayment of the financing. At that point, Thomas McNell began making secret recordings of his telephone conversations with Hugel.

These transactions occurred when Hugel was president of Brother International Corp. and a stockholder in a second company, Centronics Data Computer Corp., which did business with Brother International. Brother was founded in 1954 by Hugel, an Army associate and an expatriate as the American affiliate of a Japanese manufacturing concern, Brother Industries, Ltd., which produces a line of sewing machines and typewriters. In addition, Hugel negotiated for the Japanese company a joint production agreement with Centronics in 1971 to manufacture components for Centronics' line of high speed computer printers. Hugel left Brother International in 1975 — he was asked to leave, according to the current chief executive — and joined Centronics where he worked until joining the Reagan campaign last year.

The allegations were made in a series of on-the-record interviews with Thomas McNell, whose story was in part corroborated by his brother and further supported with their personal business records and 16 secret tape recordings of their telephone conversations with Hugel in 1974 and 1975. In addition, certain allegations are supported by New Jersey stockbroker Robert T. Blair, who worked for the McNell firm in 1974.

The tapes, documents and McNell interviews include allegations that:

- Hugel regularly disclosed confidential "insider" information about his company, Brother International, and about Centronics to Thomas McNell, who used that information to trade in the stocks of both companies. Securities law prohibits a chief executive officer from giving an unfair advantage in the marketplace by providing anyone with confidential, inside information. The tapes support this allegation.

- Hugel arranged with the McNell brothers to funnel \$131,000 into McNell Securities Corp., the brokerage firm owned by Thomas McNell, to ensure that McNell would continue to trade and promote Brother International's stock. Through the loans, never disclosed to other investors, Hugel effectively bankrolled trading activity in his own company's stock — and fueled it with the "inside" information. The McNells then attempted to enhance the stock's image as a sought-after security.

- In August, 1974, Hugel arranged for Centronics president Robert Howard to buy 15,000 shares of Brother stock in an attempt to spur trading activity in hopes that the stock's value would climb. Instead of a single purchase, the plan called for Howard to place orders for 3,000-share blocks of the stock with five different brokers on five separate days. Howard's purchase of Brother International stock followed by months a spurt of purchases by Hugel in the stock of Howard's company — also totaling about 15,000 shares.

Hugel's personal feistiness, as revealed on the tapes, was also elaborated in his own unpublished autobiography, a copy of which was provided by Thomas McNell. In the manuscript, which Hugel says was ghost-written for him, he relates a

series of episodes in which he engaged in deceptive practices in business and military pursuits, such as claiming to speak fluent Japanese in hopes of avoiding combat duty in World War II, making up intelligence reports when he was "platoon spy" for his commanding officer and lying in business deals.

In the moment of heated anger recorded by the McNells on Dec. 13, 1974, Hugel threatened their Wall Street attorney, James C. Sargent, who was a member of the Securities and Exchange Commission from 1956 to 1960.

Hugel explodes at Thomas McNell: "That sonofabitch lawyer of yours threatened me, will you imagine, threatened me with a god-damned lawsuit... what kind of s--- is that? What the f---, I'll kill that bastard."

Hugel acknowledged on Friday that the outraged voice on the tape was his, but said he did not specifically recall the matter.

In a tape-recorded interview with two Washington Post reporters last Wednesday, Thomas McNell said, "Everything that I've told you about Max Hugel, and I'm stating it for the record right now, is true." A stockbroker for 20 years, whose family held seats on either the New York or American Stock exchanges during most of the last two decades, McNell also expresses himself in strong terms.

Samuel McNell, in an interview covering the same allegations, told two reporters, "I can corroborate everything my brother has said."

Thomas McNell said that he came to The Post, which he first contacted on May 25, after unsuccessfully trying to notify White House personnel chief, E. Pendleton James, during the Reagan transition late last year. He said he telephoned James' office and left a message, warning the Reagan White House not to hire Hugel. He left his name and phone number but was never called back. James' office said yesterday it is looking for a record of the call.

In Thomas McNell's initial contacts with the newspaper, he refused to reveal his identity as he listed his allegations against Hugel. Eventually, after a series of telephone conversations and two personal meetings, the brothers agreed to provide their materials to The Post and state their allegations for the record.

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"I called the government, not the newspapers," McNell said, "just to say, 'Don't let him have the job. It's dangerous for this country.'"

Fueling their animosity, the McNells say they were forced to sell family real estate as well as their valuable seats on the New York and American Stock exchanges to pay off what Samuel McNell said "amounted to nearly half a million dollars when you include interest and legal fees" on their business debts to Hugel. In last week's interview, Hugel confirmed that the McNells repaid him about \$400,000 over the last seven years.

Both McNells were successful stock traders and investors on Wall Street in the late 1960s and early 1970s with annual incomes, according to Thomas McNell, as high as \$250,000. Today, they are running a small gas-and-oil drilling business from an office in lower Manhattan.

The CIA general counsel Sporkin contacted The Post early last Friday and said he had learned that the newspaper was asking questions about the allegations against Hugel. Sporkin requested a meeting with Post reporters and editors to review the allegations. Post editors declined Sporkin's request for a complete review of tapes and other materials, but Sporkin agreed to make Hugel available for an interview in which the allegations were presented and portions of the tape recordings were played. Sporkin said: "I have to make a recommendation," presumably to CIA Director Casey.

Hugel said that back in 1974 McNell threatened him with the revelation of unspecified tape recordings which Hugel characterized as "blackmail." But Hugel added that he never took such threats seriously and had invited the McNells to take whatever evidence of alleged wrongdoing they had to the SEC. In all, Hugel says, he was threatened five times.

Hugel emphatically denied all the allegations. Hugel also charged that McNell had "forged" Hugel's signature to obtain insurance money for a house that burned down. The house had been pledged as collateral for one of the loans owed to Hugel, who said he did not report this alleged forgery to the authorities. He said he used the check and the threat of reporting the alleged forgery as leverage against the McNells. The McNells have not been available for further comment since last week.

In the interview, Hugel denied ever giving confidential insider information about his company, Brother International, or about Centronics to Thomas McNell. "Number one, that's not true . . . I would say that I don't remember giving any detailed information although I'm sure he [Thomas McNell] probed the hell out of me."

The tape recordings show both Thomas McNell probing Hugel for information and Hugel voluntarily providing it.

On Nov. 22, 1974, according to a tape played for Hugel, the following exchange took place:

Thomas McNell: "Hi, Max."

Hugel: "Hey, got a pencil there? Get some pencil and paper, will you?"

McNell: "Yeah."

Hugel: "What I'm giving you is strictly confidential stuff, okay?"

McNell: "Right."

Hugel: "We originally forecast sales in the U.S. \$80 million in sales. We now forecast \$70 million, okay, which is a \$10 million swing. Now where does the swing come from? Okay . . . it's in three areas . . ."

Hugel then detailed sales losses in four divisions and summed up with, "you're looking at a gross profit drop of a . . . you know, about \$2,200,000 . . . And the net income which we looked at — \$4,400,000 — is now \$1,900,000."

The year-end forecast, leaked to Thomas McNell three months before the company's fiscal year came to a close, was not the promising news that McNell had hoped for, news that would push Brother's earnings to \$1.75 a share, the figure Hugel acknowledged on tape he had said would be a "safe" prediction in an earlier conversation not taped by the McNells.

Hugel said he hoped things would be better, and that "up until last night" he thought the company might earn \$1.50 a share for its stockholders at year's end. But, he added, "This is where it all is. I mean, this is why we're off as much as we are."

At that time, and for subsequent weeks, the general trading public had little or no inkling that Brother International's earnings were sliding as fast as Thomas McNell had been told. In happier times, McNell says he had received positive information from Hugel and had rushed to buy Brother stock in anticipation of the public announcement of the good news and rise in the stock value. In this instance, he withheld the bad news from his own clients because he owned a large inventory of already depressed Brother International stock whose value could be further eroded by the release of bad news.

Several weeks after that late November conversation, Hugel delivered some good news to McNell. In a Dec. 5, 1974, tape recording, Hugel detailed a contract Brother had just completed to jointly produce with Centronics a new line of computer printers — a fact that would not be announced to the public for months.

"Well, we finalized the whole thing," Hugel says in opening the conversation. ". . . It was a very, very rough negotiation, I want you to know, for about three days there . . . so that should be very, very strong for us the next year."

Thomas McNell: "Oh, good . . . That doesn't go into production until towards the end of the year, though, does it?"

Hugel: "No, I'm moving it up. We're moving it up real fast . . . trying to get it out in July."

McNell: "Fantastic."

Hugel: "Yeah, it's going to be really great. Now, I'm telling you confidential stuff, now. You understand that?"

McNell, who is taping the conversation: "Don't worry about me saying anything."

McNell told The Post that, armed with inside information, he bought more than 100,000 shares of Centronics through his brokerage firm during the fall of 1974. "I knew everything that was going on inside of both of those companies," he said, "and I was banging the hell out of it for my clients."

The steady flow of insider information from Hugel to Thomas McNell was confirmed by Robert T. Blair, the vice president of McNell Securities in 1974 and now a stockbroker in New Jersey. Blair, 43, said last week, "That's the salesman in Max. His enthusiasm for what he believed in kept him saying things he probably shouldn't have said."

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Blair said Thomas McNell would tell him — following conversations with Hugel — precise figures on earnings projections and contracts won by Brother International weeks before the information was made available to the public.

"You have to understand that when you're dealing with a person like Max Hugel — it may be wrong, but you'll see the stock move [as a result of leaked insider information] a couple of days before it hits the [public] tape — it happens quite often," Blair said.

The financial relationship between the McNell brothers and Hugel began in early 1974. Thomas McNell had been a longtime trader in Centronics stock for his clients and was introduced to Brother International through its close relationship to Centronics.

Hugel and Thomas McNell each say that the other made the first approach, but regardless, McNell Securities Corp., a three-man brokerage firm owned exclusively by Thomas McNell, agreed to become a market maker and promoter of Brother International's stock. Making a market in a stock that is not listed on a major exchange and is traded over the counter means that a broker buys it up to maintain an inventory for sales to the public and to other brokers.

Thomas McNell alleges that his firm soon began to run low on capital and that Hugel indirectly invested at least \$131,000 in McNell Securities to keep it in business and trading in the stock. Brother International, being a newcomer to the stock market at the time, had virtually no one but McNell Securities making a market in its stock. According to securities experts, at the very least Hugel's financial relationship with the securities firm ought to have been disclosed to all investors.

Hugel knew it would be illegal for him to put money directly into McNell's firm, Thomas McNell said, so a plan was allegedly devised to route two loans, \$31,000 on July 17, 1974, and \$100,000 on Aug. 7, 1974, through a middleman into Thomas McNell's firm.

The middleman was Samuel McNell, in whose separate brokerage business Hugel was also investing \$250,000, records show.

The scheme allegedly called for Hugel to loan the money to Samuel McNell, who in turn gave the money to Thomas McNell. To create a paper trail to show that Thomas McNell did not receive free money, he signed over two pieces of property in Vermont to his brother.

But the purpose of all this, says Thomas McNell, was for Hugel to pump new capital into the firm that was promoting his stock. "I never sold the houses to Sam," says Thomas McNell. "It was a paper transaction. It was a sham."

In a Dec. 8, 1974, tape recording, Hugel himself demonstrated that he knew the true destination of the money.

"As far as I'm concerned," he said to Thomas McNell, "I didn't lend you the money, I loaned it to him [Samuel McNell] on the basis that he was going to buy the homes from you so that there could be no transaction whatsoever that I loaned you the money, which I didn't — I lent it to him and he, in turn, was not lending it to you, he was buying homes from you."

In Friday's interview, Hugel states clearly that he knew it would have been wrong for him to put money into Thomas McNell's stock trading operation. "I wanted absolutely no point in hell that if he was making a market on my stock that I was loaning money to him directly, even for some personal reasons... that would be against every principle and whatever the laws were."

In the same interview, Hugel acknowledged that he knew the money, at least the \$100,000, went directly from Samuel to Thomas McNell.

Hugel, however, makes a distinction by saying he was loaning the money to Thomas McNell "personally" to help him out of some unspecified tax problems, but not to help the firm. "I did not invest in McNell Securities.... I just learned today that that money went that way."

On several tape recordings provided by Thomas McNell, Hugel discussed the repayment of his loans directly with Thomas and shows broad knowledge about the stock losses that depleted McNell's capital.

Hugel shows specific knowledge that Thomas McNell is the sole owner of McNell Securities and says on a Dec. 13, 1974, tape, "... whether Tom McNell has it or McNell Securities, I can't see what the difference is, personally."

At one point, Thomas McNell assures Hugel that "my brother and I are just like Siamese twins."

Two other close associates who were part of Hugel's business circle at the time remembered the loan agreement differently. Robert Howard, president of Centronics, said last week, "There was some dealing where Max was investing in a brokerage firm. I know he was involved in the company [McNell Securities].... I told Max after the fact, 'There is no way you should be an investor.'"

Howard added, "Max was duped into some sort of a personal loan.... Max was guilty of trusting and a victim [of the McNell brothers.] In my view, there were some very serious things that were done wrong by the McNell brothers."

Blair, who was vice president of McNell Securities in 1974, recalled in a telephone interview last week that Hugel's investment in the foundering brokerage firm was the worst-kept secret in the office.

"The firm had reached the point where it needed a transfusion [of capital] and Max's money appeared to be available, for a price." The price, Blair said, was "working with the Brother situation, promoting the stock...."

The pressure from Hugel to promote Brother International's stock was, according to the McNells, the driving force to create a false sense of active trading in the stock and to push up or try to maintain its value as the stock market declined that fall.

Hugel denied ever urging the McNells to do this. "Absolutely not. Never, never," Hugel said last week.

But a tape recording on Dec. 6, 1974, tells a different story. On the tape, Hugel complained: "I don't think we got anybody trading. I mean, what could be a better buy right now than Brother at \$3?.... Tom, maybe you're tapped out but I'm trying to get somebody out there that isn't tapped out... maybe we got to bring some new blood into the goddamned thing... new trade, doesn't have to be much. A thousand. Something like that. What the hell's the big deal here. At least trade, I don't care even if they trade

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it down. As long as they trade! A hundred shares [which was all that had been traded in Brother stock the previous day] — Jesus Christ, that's an insult. That's an insult to knock my stock a half a point on a lousy hundred shares ... that's \$300. S---. We p--- that out every morning."

Hugel then said he wanted "the greatest PR exposure . . . And I'm going to blow this thing right into China if I have to."

In a statement that appears to acknowledge the large role played by the McNells, Hugel said that Brother stock had "no support at all right now. I mean zero. So it's just floating, like in space. Like before you came to me. Remember before you came to me? We had nothing . . ."

In a passage that strongly suggests Hugel's personal reason for wanting to raise the value of his stock, some of which was pledged as collateral for loans, Hugel told the McNells in the taped telephone conversation, "Christ almighty, Sam, I'm getting more f---ing headaches than I know what to do with the goddamn thing. Got my bank on my ass, 50,000 guys on my ass and it doesn't really take that much . . . Maybe, Tom, we could work together with some other people . . . get them behind the goddamn thing, too . . . let 'em bang it all over the goddamn place, but let's get the action."

Howard, of Centronics, defended Hugel by saying, "Max was very, very unsophisticated and unknowledgable and he thought he was a lot smarter than he was . . . He was overenthusiastic about stock market things . . . and should have worried about earnings."

Part of the action that Thomas McNell alleges Hugel engineered was certain trading in Brother and Centronics stock. McNell maintains that in August, 1974, Hugel arranged to have Howard buy 15,000 shares of Brother stock in 3,000-share blocs through five brokers — a plan designed to create high trading visibility for the Brother stock.

Of the allegation, Hugel said last week, "The answer is absolutely, unequivocally no."

The McNells have no tape recording to support this allegation, but Thomas McNell alleges: "I had a meeting at Max Hugel's office with Bob Howard and Max Hugel. An arrangement was made where Bob Howard would buy 3,000 shares of

Brother International from each of these brokers on different dates, [thus] lending the credibility of Centronics to Brother International . . . [As if to say:] Things were going so great that even Bob Howard was buying in at 10¼, 10½. It was stock manipulation."

"And the whole reasoning that Max had," continued Thomas McNell, "was that these people could tell their clients, 'Hey, Bob Howard is buying it.' . . . [and] there was buying of the stock as a result."

Howard said that if the purpose was to run up the price of the Brother stock and use him as a sales gimmick, then "that constitutes stock manipulation and I knew nothing about it." While acknowledging he bought the total 15,000 shares, he says it was Thomas McNell's idea: "He conned me into this."

Howard denies that he met with Hugel to concoct such a scheme. "I never discussed that purchase with Max," Howard says that until last week he had never heard that five brokers were used in the purchase and added, "I was used . . . this was the first I heard of five brokers."

Two of the five brokers named by Thomas McNell were reached last week, however, and both said they had received telephone calls from Bob Howard on Aug. 13, 1974, and Aug. 15, 1974, respectively and both said Howard placed an order for 3,000 shares of Brother stock with them at \$10½ per share. Both said that the order was the first and last they had ever taken from Bob Howard for Brother stock.

One of the brokers, Stuart Brown, research director at Drexel Burnham Lambert Inc. in New York, said, "It was the only transaction I ever had in Brother International."

The second broker, Jack Fox, who works for Dean Witter Reynolds Inc. in Short Hills, N.J., said, "Yeah, I remember the trade . . . it came out of the blue." Fox says he received his call from Howard two days after Brown had received his. "This is the one trade I ever did with Howard," adding that he figured at the time that Howard was placing the order through his firm as "a kind of 'Thank you' for the help some of us had done in promoting Centronics."

Yesterday, Howard called again to say, "I've made some serious mistakes in my recollections . . . I did buy Brother International shares directly; it was with several firms." Howard said he did not know why he conducted so many separate transactions. "I've been asking myself that . . . I really don't know why."

Howard said that he is still sure he was not involved in a meeting with Hugel and Thomas McNell in which the plan was devised. "I may have been talking with Tom and Max . . . but I know nothing wrong was done." Howard said he lost \$94,000 on the Brother stock he bought for \$125,000, according to his income tax filing for the year.

In late 1974, the financial relationship between Hugel and the McNells was deteriorating rapidly as the plummeting stock market eroded the value of McNell's stock inventory, bringing pressure from lenders and regulatory authorities on the McNells to put up more capital. On Sept. 13, the SEC closed the doors of McNell Securities and within days, Hugel had one of his lawyers contact Samuel McNell to seek cancellation of their partnership agreement, records show. But Thomas McNell continued to trade as a broker through another firm and continued his close contacts with Hugel even though Hugel was pressing for stronger collateral for his loans and prompt payment of interest charges.

The McNells, in their own words, were "tapped out," out of cash.

As the loan payment negotiations heated up, the McNells said their lawyer, Sargent, suggested to Hugel's lawyer that Hugel could find himself in a shareholder lawsuit for having disclosed inside information to Thomas McNell.

A Dec. 13, 1974, tape recording shows Hugel's reaction upon learning of the threatened suit:

"And then he had the audacity, the nerve to threaten me with some goddamn cockamamie lawsuit, that I, it's so distasteful to me that I'm ready to throw up. Did you [Samuel McNell] know that?"

Samuel McNell: "No."

Hugel: "That he threatened me, Sam, with a suit about giving confidential information on the company's earnings and this and that to Tom, after all we been through? What the f--- kind of s--- is that?"

McNell: "Hey Max, I didn't even hear about that."

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Hugel: "He's threatening me with a suit? Let the f----- sue me."

McNeill: "What he said to me, Max, he said that you had, that he had said that you hadn't talked to . . ."

Hugel: "That's bull---, Sam, I've been at that c---sucker, I'll put that bastard in jail."

McNeill: "Well, I'm just saying what he said, Max."

After several more minutes of heated conversation, Thomas McNell comes on the line and asks Hugel why the lawyers are so upset.

Hugel: "And that c---sucker, that sonofabitch lawyer of yours threatened me, will you imagine, threatened me with a goddamn lawsuit for revealing like secrets of the company to you. What kind of s--- is that?"

Thomas McNell: "Hey, Max, I don't know what he said, okay?"

Hugel: "What the f--- — I'll kill that bastard . . . I've revealed nothing to you guys, all I did — I did nothing wrong, and I'll stand up in any court . . . and I don't want to get in a legal battle with you guys."

Sargent, SEC commissioner during the Eisenhower administration and longtime partner at Whitman & Ransom in New York, said he did not recall threatening Hugel with a lawsuit.

In May, 1975, Thomas McNell recorded one of his last conversations with Hugel. At this point, Hugel is urging him to come up with additional cash for the loan payment schedule in what Hugel calls "the spirit of good will, friendship for a guy that needs the cash."

Thomas McNell replies, "Max, you know me."

"I know you," Hugel says, "I know you to take good care of me, because, you know, beyond what you owe me, there's a few things you owe me, right? . . . And I'm leaving it to you, and if you don't do anything, you don't do anything. What can I do. If you do, I'll kiss you on both cheeks. And if you don't, I'll cut your balls off. You got no choice, anyway. I'll get my Korean gang after you and you don't look so good when you're hanging by the balls anyway."

This is followed by strained laughter from Thomas McNell.



By Fred Sweets — The Washington Post
Max Hugel, head of CIA covert operations

ARTICLE APPEARED
ON PAGE A8

THE WASHINGTON POST
14 July 1981

Hugel: 'I Deny Any Wrongdoing'

Max Hugel issued the following statement through his attorney last night:

"I have considered the information which has been supplied to The Washington Post by two former securities brokers. I am deeply disappointed that this newspaper has determined to lend its credit and dignity to the accusations of two men such as the McNell brothers. I enjoy an excellent reputation as an energetic and aggressive executive. These are the skills that I have brought to my present position in a desire to further the interests of the United States.

"The fact of the matter — and this is incontrovertible — is that I have never made a penny of unlawful profit or done anything else to bring discredit upon my company, my family, myself, or the United States. I deny any wrongdoing, and I can demonstrate that none was intended or committed.

"I shall continue to serve my country as long as it requires my services, and long after these rantings from the past have ceased. I will leave the question of the accuracy of The Post's statements and the fairness of its comment to my associates."

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THE WASHINGTON POST
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Casey Appointed A Man He Trusted

By Lou Cannon
Washington Post Staff Writer

When CIA Director William J. Casey appointed Max Hugel as the nation's chief spymaster, the action so astonished top-ranked White House officials that Casey wrote a letter to President Reagan explaining his unusual selection.

"It was a coup by Casey," a well-placed White House aide said yesterday.

If there was anyone in the White House who wasn't surprised by that action, which was made public in mid-May, he couldn't be found yesterday. One well-placed official said that the president's top triumvirate of aides — chief of staff James A. Baker III, deputy chief of staff Michael K. Deaver and counselor Edwin Meese III — were all caught off guard by Casey's decision.

There was an immediate outcry from intelligence officials as well as those who worked with Hugel in the 1980 Reagan campaign. Hugel's job as deputy CIA director for operations is one of the most sensitive and important in the government.

The response prompted Casey to defend his selection. In his letter to Reagan, the CIA director argued that Hugel possessed valuable managerial skills and had proven himself in the Reagan campaign. Casey also claimed that Hugel's campaign work organizing ethnic groups was similar to organizing covert operations.

Casey said in his letter that he had known and trusted Hugel for 20 years and wanted someone from outside the intelligence community to prevent in-fighting for the job.

"Does the White House know about this?" was the first response of Stuart K. Spencer, Reagan's chief 1980 campaign strategist, to Hugel's appointment.

Despite such warning signals, which included strongly voiced private objections from prominent members of the intelligence community, the White House did not overrule Casey. High-placed officials deplored the choice but said it was Casey's to make.

Yesterday, Casey declined to comment on his reasons for picking Hugel, who went into the CIA with him Jan. 21 as a special assistant and then was promoted to deputy director of administration, before being chosen to head the operations directorate.

But others in the administration tried to explain Casey's reasoning.

"Max had done a lot of overseas work," Meese told The Washington Post last week. "That's been a large part of his professional career as an overseas marketer. Also, Bill admired his ability to manage things in the campaign and felt he would be the right person to put in that job."

"He restructured that particular segment of the agency by having, in essence, a lay administrator, a non-career administrator, and then had two career specialists in charge of the two halves, which they had not had before . . . He was interested in having, as part of his total management plan over there, someone he could rely on 100 percent."

Such explanations have failed to satisfy CIA professionals.

A former deputy director of operations for the agency said yesterday that Hugel "substitutes profanity for thought" in a job that is one of the most important in the CIA.

"This person is in charge of assignments and judgments in the field of covert intelligence, picking station chiefs and deputy station chiefs in foreign countries, making the final decisions on covert operations and on personnel," this former official said. "This is the man who decides on whether or not a covert action is practically feasible. There is no substitute for experience in that area."

Another high-ranking career CIA expert questioned the wisdom of appointing anyone with a stocks-and-bonds background to be deputy director of operations (DDO).

"There is no way a DDO can be in stocks or commodities because sure as hell you're going to be accused of insider information, given the character of people you deal with and the information you receive," this CIA expert said.

To understand why Casey was allowed to choose someone with such an apparently inappropriate background for the DDO job, it is necessary to understand the relation forged between Reagan and Casey in the presidential campaign.

The 68-year-old Casey, chairman of the Securities Exchange Commission during the Nixon administration, joined Reagan in February, 1980, when the Reagan campaign was spending money so fast the candidate feared he would be bankrupt long before the Republican convention. Casey introduced strict spending controls, and Reagan was so grateful that Casey became one of his most trusted aides, enjoying a position usually reserved for longtime Reagan insiders.

When Reagan won the New Hampshire primary two weeks later, he fired campaign manager John Sears and installed a collective leadership — the forerunner of the present collective leadership in the White House — consisting of Casey and Meese. Later, Spencer and Deaver became the chief operatives on the Reagan campaign plane, in effect sharing the campaign leadership.

Hugel, 56, already was part of the campaign when Casey arrived, but his role was a small one. He was Nashua town chairman in the New Hampshire primary, as the result of a recommendation of William Loeb, the influential publisher of the Manchester Union-Leader.

In a front-page editorial that inspired snickers among some Reagan campaign operatives, Loeb credited Hugel with a vital role in the election, calling him "the man with the answers."

Actually, there is support for Loeb's view by some campaign veterans. One knowledgeable member of the campaign team said that Hugel did "a competent job" in organizing ethnic voters in the national campaign.

Another aide who spent a lot of time on the campaign called Hugel "a political idiot" who tried to overschedule Reagan into minor events and who needlessly irritated political workers.

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The least favorite example of a Hugel political brainstorm was his proposal for organizing 10 million volunteers who would call on another 20 million Americans and presumably win the election through their sheer weight of numbers.

On one occasion when a campaign aide disagreed with him, Hugel said that he would have fired the subordinate if they were in private business. It was pointed out to Hugel that this was the difference between business and a political campaign.

This story points up the quality that many believe attracted Casey to Hugel, a tough-talking, self-made man from the New York streets who made himself valuable as a man who got things done.

"He came up harder than the hard way," says an administration official who knows him well, "and sometimes when you do that everything isn't always neat and clean."

Casey, also a self-made man, has at times been accused of borderline conduct himself although he received high marks for his management of the SEC. He was the defendant in a suit that alleged violation of the securities laws and misrepresentation of the value of some stock. The suit was settled out of court.

But Casey has never made any secret that he prefers hard-charging operatives to those who strain at legal niceties. In choosing Hugel for the spymaster post, he once more put his philosophy into practice.

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NEW YORK TIMES
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Worry Over Illegal Arms Exports Growing Among U.S. Prosecutors

By PHILIP TAUBMAN

Special to The New York Times

CHINA LAKE, Calif., July 8 — Federal investigators and prosecutors say they are increasingly concerned about the extensive illegal exporting of arms and sophisticated technology from the United States to countries such as Libya and the Soviet Union.

As examples of what they view as a serious and growing national security problem, the law-enforcement officials cite the theft of military equipment from the Naval Weapons Center here and the involvement of former weapons specialists at the center in training Libyan terrorists.

Neither case has been resolved. The investigators and prosecutors involved in the China Lake cases say that it is evident from these and similar cases that senior American officials are neither fully aware of the severity of the problem of illegal arms exports nor prepared to take sufficient steps to deal with it.

In response, senior officials of the Justice, State, Commerce and Treasury Departments say they realize there is a problem of illegal exports and concede that the Government has been slow to mobilize efforts against it. They place the blame on Federal bureaucratic inertia.

There have been allegations in legal proceedings that the Central Intelligence Agency is behind some of the illegal activity connected with the China Lake cases, supposedly to exchange American military hardware for sophisticated Soviet radar equipment, but the agency denies it. Federal prosecutors say they are generally satisfied with the denial, although some say they are not entirely convinced by it.

The first incident at the Naval Weapons Center, an installation in the barren reaches of the Mojave Desert that conducts highly classified research in explosives and electronic warfare, occurred in September 1979, when officials here discovered that 10 Starlight infrared nightscopes, a low-light television camera and a small remote-control helicopter were missing. The Federal Bureau of Investigation was called in, and its agents were told by some suspect employees that they had stolen the goods as part of a C.I.A.-sanctioned plot, to obtain Soviet radar equipment for study.

Later, there was a chain of arrests and indictments in Philadelphia and Lexington, Ky., involving the illegal possession of weapons and further talk about arms deals in Libya involving Soviet electronic equipment.

Then, last December, officials said they learned that two other civilian employees of the center, while on leave in 1976 and 1977, apparently traveled to Libya, where they served as instructors in handling explosives at a camp for training terrorists set up by Edwin C. Wilson and Francis E. Terpil, two former C.I.A. agents. Mr. Terpil and Mr. Wilson are now under indictment for conspiring to transport explosives illegally to Libya.

Despite the intersections between the two cases, including the fact that they both involved employees at the Naval Weapons Center, the Justice Department has not coordinated investigations. When the first case started to spread to disparate jurisdictions around the nation, officials in the department's criminal division rejected a request by the United States Attorney in Philadelphia that the investigations there and in Lexington and California be handled by an interagency investigative force.

'Fumbling Around the Country'

"We banged our head against the wall for months trying to get some coordination," said Roberto Rivera-Soto, a former Assistant United States Attorney in Philadelphia now in private practice. "Some kind of task force should have been organized. Instead, we had a bunch of assistant United States attorneys fumbling around the country because they didn't know what each other was doing."

One result of the lack of coordination, officials said, was a 19-month gap between the discovery of the theft of hardware at China Lake and indictments in the case by a grand jury in Fresno, Calif. As a result, officials said, a trial is to begin next month on the charges in the first of the complex sequence of events, long after cases involving later phases of the sequence were tried. That reverse sequence, officials said, has hampered prosecution efforts.

Senior officials in the Justice Department acknowledged that they had declined requests to coordinate the various investigations. They said that the flow of investigative information between agencies and prosecutors was satisfactory.

These same Justice Department officials, who asked not to be identified, acknowledged that there was growing concern in various Federal agencies about the problem of illegal export of arms and technology but said that efforts to coordinate law enforcement activities had been stalled by bureaucratic delays and interagency feuding.

"The full dimensions of the illegal export problem are not even known," said a senior official in the criminal division. "It is a potentially lucrative arena for criminal activity in which there is a minimal risk of detection, a minimal risk of apprehension and minimal penalties if you are caught."

Laws on Arms Exports

Under several Federal laws, the State Department and Commerce Department are responsible for licensing and monitoring the export of arms and technology. The State Department, for example, maintains a munitions list of arms that cannot be exported to friendly nations without a license and are banned from export to unfriendly nations.

In the last decade, the Commerce Department uncovered about 50 cases involving the illegal export of computer, optics and weapons technology to the Soviet Union, a number that investigators said was probably a fraction of the actual total.

Officials said that illegal weapons and technology export could take several forms. In some cases, legitimate export licenses are obtained from the Government under the pretext that the goods are being shipped to a Western European nation; they are subsequently transshipped from Western Europe to the Soviet Union. In other cases, fraudulent export licenses are obtained by bribing Government officials. Several cases of both types have been prosecuted, with several convictions.

Matthew T. Crosson, deputy chief of the fraud bureau in the Manhattan District Attorney's office said an investigation into gun smuggling by Frank Terpil in 1979 found evidence of widespread illegal arms shipments to Libya via Portugal.

Mr. Terpil and Mr. Wilson face Federal charges of shipping large amounts of explosives to Libya as part of a plan to train Libyans in terrorist techniques. Mr. Wilson, Mr. Terpil and Jerome S. Brower, a California explosives manufacturer said to have participated in the plan, were indicted in Washington in April 1980.

Mr. Brower pleaded guilty earlier this year to one count of illegally shipping explosives. Mr. Wilson and Mr. Terpil are living abroad and have not been apprehended.

The certain connection of one of the China Lake cases to the Wilson-Terpil operation and suspicions, so far unproven.

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en, that the other may be connected have focused unwelcome attention on the China Lake installation.

The case connected to Edwin C. Wilson and Mr. Terpil involves the terrorist-training activities of two former weapons-center civilian employees, Robert E. Swallow and Dennis J. Wilson, the latter no relation to Edwin C. Wilson. Mr. Swallow and Dennis Wilson have been investigated but have not been charged with any crime. No law prohibits Americans from training terrorists abroad.

According to Federal investigators, Mr. Swallow and Dennis Wilson, who had top-secret security clearances, took unpaid leaves from the center in late 1976 and early 1977 to go to Libya to work at the terrorist training camp set up by Edwin Wilson and Mr. Terpil.

Navy officials at the center said that they did not learn about the true purpose of the leaves until they read newspaper reports late in 1980, and Capt. J. W. Patterson, the chief staff officer at the center, said that had officials known the nature of their plans, the leaves would not have been granted.

Defense Department officials familiar with the case said that in his application for a leave, Mr. Swallow stated, "I have an opportunity to assist in opening and managing an explosives sales and demolition consulting office in Libya for the J.S. Brower & Associates Inc. of Pomona, Calif."

Despite that statement, made at a time when United States relations with Libya, a militant Arab North African nation, were strained, and Libya was viewed as a source of aid to terrorist groups, officials of the center granted the leave as a routine matter.

Work on Sensitive Projects

Though neither Mr. Swallow nor Dennis Wilson was working on particularly sensitive projects when they went to Libya, Defense Department officials said that the two men had worked in the 1960's on Project 308, a highly classified effort by the C.I.A. and Defense Department to develop weapons for special warfare in Vietnam.

Dennis Wilson resigned from the center in September 1973. Mr. Swallow went on sick leave in December 1980 and has not returned to work. Reached by telephone, Mr. Wilson declined to comment. Mr. Swallow was said by someone who answered the phone at his home to be on vacation and unavailable for comment.

Federal investigators are exploring their involvement in the Edwin Wilson-Frank Terpil operation, looking for other connections between it and the weapons center. Officials at the center said they had not reviewed other leaves in the same period to see if anyone else had worked in Libya.

Federal investigators are also exploring possible connections between Mr. Swallow and Dennis Wilson and the other China Lake case, the 1979 loss of equipment.

According to the indictments handed down in Fresno in March 1981, two civil-

ian employees at the center, James S. Nichols and Ralph E. Calvani, were involved. Mr. Nichols, who resigned last week, was an electronics technician, is charged with embezzlement of government property. Mr. Calvani, who left the center in 1977, was also an electronics technician, working in the electronic warfare department, which handles the center's most sensitive research and testing. He is charged with receipt of embezzled government property. Both were telephoned repeatedly but could not be reached.

Also charged with receipt of embezzled Government property in the case are Larry E. Bryant, a retired Air Force electronics expert, and his cousin, Bradley F. Bryant.

When he was first questioned about the missing equipment, according to investigative reports prepared by the Bureau of Alcohol, Tobacco and Firearms, Mr. Nichols explained that he had removed the equipment as the first step in a complex plan, sponsored by the C.I.A., to trade military equipment in Libya for a piece of Soviet radar equipment.

According to officials at China Lake, the center has, on occasion, been supplied with Soviet radar equipment in order to test countermeasures. Officials say they do not know, and do not ask, how the Soviet equipment is obtained.

The Federal Bureau of Investigation traced some of the nightscopes, used to aim weapons at night through infrared detection, to Las Vegas, where agents observed them being transported by Larry Bryant in a car.

In an interview in Las Vegas last week, Larry Bryant said that he did not know that the cartons he was transporting contained nightscopes. Mr. Bryant said that while stationed at Nellis Air Force Base near Las Vegas, he had made occasional trips to China Lake to assist in research projects. Officials at the center said that Mr. Bryant had worked closely at the center with Mr. Calvani.

Arrests in Philadelphia

On Jan. 4, 1980, while the disappearance of the nightscopes and other equipment was under investigation in California and Nevada, the Philadelphia police arrested Bradley and Larry Bryant at an airport hotel. The pair were being watched in a routine vice investigation, and the police said that they found a small cache of arms in Bradley Bryant's suitcases.

According to the Philadelphia police and Federal investigators, both Bryants told the authorities that they were working for an unspecified Government agency. Larry Bryant, these officials said, told officers that the guns were part of a plan to trade weapons in Libya for Soviet radar equipment and that the project was authorized by the C.I.A.

Larry Bryant, in an interview, said that story was a garbled version of what he had told the police. He said that he had told them that he had specialized in electronic warfare in the Air Force and knew a lot about Soviet radar and that he might also have mentioned discussions in the early 1970's among his col-

leagues in the Air Force about a plan to swap American military equipment in Libya for an important piece of Soviet radar equipment. The plan was never carried out, he said.

The Philadelphia police, he said, had twisted these separate stories into one story.

After the acquittal of Larry Bryant on charges of illegal possession of a silencer and the conviction of Bradley Bryant on the same charge, the reported C.I.A. connection was raised anew at the April 1981 sentencing hearing.

Alleged C.I.A. Contract

Assistant United States Attorney Steven Weiner testified that Bradley Bryant claimed that "he was under C.I.A. contract during the time" of his arrest. Mr. Bryant's lawyer, Oscar Goodman, said his client had not said he had a contract with the C.I.A., but had told prosecutors of a contract with an unnamed Government agency.

Mr. Goodman, in an interview, said that the issue of Bradley Bryant's possible relationship with the C.I.A. was a confidential matter covered by lawyer-client privilege.

The C.I.A. denied at the time, and still does, that any of the figures in the stolen hardware case from China Lake had connections with the agency.

The arrests in Philadelphia led to the search of a warehouse in Lexington rented by Bradley Bryant where police found a large arsenal of weapons valued at more than \$250,000, various electronic surveillance devices and an infrared nightscope. Federal authorities believe that the nightscope found in Lexington was one of the 10 from China Lake.

Larry Bryant was not charged in Lexington. Bradley Bryant was acquitted there in May 1980 on a charge of illegal possession of firearms.

On May 20 of this year, Bradley Bryant was arrested in Illinois and charged with unlawful delivery of 804 pounds of marijuana to Federal undercover agents. He is currently being held in prison in Elgin, Ill.

Bartering for Weapons

Federal authorities who are familiar with these cases said that they believed the hardware stolen from China Lake was actually intended for use in exchange for drugs in Colombia. They discount the possibility that either Larry Bryant or Bradley Bryant or the two civilians from the weapons center seriously hoped to swap the hardware and weapons in Libya.

But sources in the Defense Department said that at the time the equipment was removed from China Lake, Government agents covertly acquiring Soviet electronic weapons systems often resorted to bartering American military equipment in third-party nations such as Libya.

Several prosecutors said that if the weapons recovered in Philadelphia and Lexington and the equipment removed from China Lake had been used in a drug trade, the troubling possibility would remain that American weapons and technology might eventually find their way into unfriendly hands.